Supreme Court, U.S.
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Nos. 00-1065 and 00-1066

In The

Supreme Court of the United States

ERNEST N. MILES, ET AL., *Petitioners,*

v.

UNITED STATES OF AMERICA, *Respondent.*

DOUGLAS R. WILLOUGHBY, ET AL., *Petitioners,*

v.

UNITED STATES OF AMERICA, *Respondent.*

On Petitions For Writs of Certiorari
To The United States Courts of Appeals
For The Second and Federal Circuits

PETITIONERS' REPLY TO UNITED STATES' BRIEF IN OPPOSITION

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INTRODUCTION

Respondent's Brief in Opposition mischaracterizes both the factual records and the opinions below. These mischaracterizations obscure the actual legal holdings in these cases, which are important and incorrect interpretations of this Court's decision in *Commissioner v. Schleier*, 515 U.S. 323 (1995).

Respondent portrays the courts below as having found (1) that petitioners had no bona fide potential tort claims that could have been settled and (2) that IBM therefore could not have made the payments to petitioners to settle their potential claims.

In fact, the courts below did not address whether petitioners had bona fide potential tort claims that they could have asserted against IBM. Instead, the courts relied on incorrect legal holdings that made the existence of bona fide potential claims irrelevant.

As petitioners stated in the Petitions, the decisions below hold that where payments to a group of departing employees are based on salary and length of service, the payments are includable in income and subject to FICA taxes *even if* the employees have bona fide tort claims that they could have asserted against the employer and the employer's reason for making the payments is to avoid the employees' potential claims.

RESPONDENT'S ERRONEOUS STATEMENTS REGARDING THE FACTUAL RECORD AND THE OPINIONS BELOW

1. Regarding the record and lower court decision in the *Miles* case, respondent states: "In fact, (i) petitioner acknowledged that he had suffered no personal injury and (ii) the court found that petitioner had adduced no facts that could support a bona fide tort or tort-type claim against IBM. 00-1065 Pet. App. 15a." Resp. Opp. 5 n. 3.

Both parts of respondent's statement are false.

a. Petitioner Miles did not stipulate that he had suffered no personal injury. Rather, he stipulated that he had experienced no symptoms of physical or emotional harm. Moreover, he testified that he suffered embarrassment, humiliation, and *reputational* harm.

b. The district court did not find that petitioner Miles adduced "no facts that could support a bona fide tort or tort-type claim." Rather, the district court found that Miles adduced "no facts that an underlying bona fide tort or tort type claim existed." 00-1065 Pet. App. 15a. Read in context, the quoted statement means only that there was no open dispute between Miles and IBM. Thus, the district court's actual finding is quite distinct from a finding that Miles did not have any bona fide claim that he *could have asserted*. This distinction is the very foundation of the third Question raised in the *Miles* Petition. Under the decision below in the *Miles* case, a payment made for the purpose of avoiding a bona fide potential personal injury claim that has not yet been asserted cannot be treated as a settlement for purposes of I.R.C. § 104(a)(2).

2. Regarding the lower court decision in the *Miles* case, respondent states: "The court explained that, at the time petitioner signed the general release and received the payment, he was not aware that he had suffered, and in fact was not suffering, from personal injuries." Resp. Opp. 6. This statement is erroneous. The district court did not state or imply that petitioner Miles was not suffering from personal injuries such as reputational injuries.

3. Regarding the lower court decision in the *Willoughby* case, respondent states: "The court noted that not only had none of petitioners suffered any personal injuries or threatened any claim against IBM . . . ." Resp. Opp. 9. This statement is erroneous. The Court of Claims did not state or imply that none of the *Willoughby* petitioners suffered any personal injuries such as reputational injuries.

4. Respondent states: "The payments are in the nature of severance pay. . . . [T]hey were not provided in exchange for the relinquishment of any preexisting contractual right." Resp. Opp. 11. This statement incorrectly implies that the payments IBM made to petitioners were made on account of petitioners' past services and were not in exchange for the relinquishment by petitioners of valuable rights. Respondent's statement is belied by the record. IBM's witness testified that the payments were *not* made as remuneration for services. 00-6029 C.A. App. 211; 99-5136 C.A. App. 1232. IBM's witness also testified that the payments were "part of an approach used during 1990 to 1995 that was designed to ensure that IBM's departing employees would not sue the company after they left." 00-6029 C.A. App. 208-09; 99-5136 C.A. App. 1225-26. In the *Willoughby* case, respondent stipulated that the payments to petitioners

were made in exchange for executing releases. 99-5136 C.A. App. 948-49.

5. Respondent states: "Petitioners err in suggesting . . . that the payments were not intended as a substitute for income." Resp. Opp. 12 n. 7. Respondent's statement is false. IBM's witness testified as follows:

> Q. Did IBM intend the payment provided under the voluntary transition programs during 1990 through 1996 including the ITO-2 program to be available as a form of severance pay and as a substitute for the income that the employee would otherwise have earned while working at IBM?
>
> A. I think the answer to that is probably no because it wasn't meant to be a substitute for the income that they otherwise would have had at IBM. . . . So it was not meant to be a substitute for their income.

00-6029 C.A. App. 144; 99-1536 C.A. App. 1146

6. Respondent incorrectly denies that post-*Nierotko* decisions have held that payments to employees for noncompensatory reasons are not "wages" for FICA purposes, asserting that the cited decisions "hold only that an employer's reimbursement of costs incurred by employees does not represent 'wages' subject to FICA taxes." Resp. Opp. 13-14. Respondent's assertion is erroneous. Respondent ignores the fact that the *reason* the reimbursements at issue in the cited cases were held not to be wages was that they were *not made as remuneration for services.*

7. Respondent erroneously states that it is a longstanding holding of this Court that "payments derived from the employer-employee relationship represent 'remuneration for employment' to which FICA taxes apply." Resp. Opp. 15, *citing Social Security Board v. Nierotko*, 327 U.S. 358 (1946).

Nierotko did not hold that "payments derived from the employer-employee relationship represent remuneration for employment." *Nierotko*, which dealt with back wages awarded to a wrongfully discharged employee, held only that the term "service", as used in the Social Security statute, means "the entire employer-employee relationship for which compensation is paid to the employee by the employer." 327 U.S. at 365-66. In *Central Illinois Public Service Co. v. United States*, 435 U.S. 21, 30-31 (1978), decided 32 years after *Nierotko*, this Court flatly rejected the United States' argument that all payments from an employer to an employee are "wages." Similarly, in *Royster Company v. United States*, 479 F.2d 387, 390 (8th Cir. 1973), the Eighth Circuit stated: "We cannot agree that any payment made to the employee which is 'attributable to the employment relationship' constitutes wages . . . ." *See also* the cases cited at 00-1065 Pet. 17-18; 00-1066 Pet. 17-18.

8. Respondent asserts: "[T]he courts below correctly concluded that there was no settlement of any tort-type claim since neither party knew 'any such claim existed,'" citing 00-1065 Pet. App. 17a (district court decision in *Miles*). Resp. Opp. 17. This assertion erroneously implies that the courts below determined that the payments to petitioners were not "settlements" because IBM was not aware that it would face a serious risk of tort claims if it

did not make the payments. Neither court below made such a determination.

a. The district court in the *Miles* case determined only that IBM was not aware of *petitioner Miles' specific claims.* 00-1065 Pet. App. 17a. Thus, the district court concluded as a matter of law that IBM's recognition of its tort risk from the departing employees *as a group* was insufficient to cause the payment to any particular employee to be a settlement. This characterization of the *Miles* decision is reinforced by the Court of Claims' acknowledgment in the *Willoughby* case that "IBM had serious and realistic concerns about the threat of lawsuits that could be brought, including concerns about arguably tortious acts, and the emotional suffering caused by downsizing." 00-1066 Pet. App. 21a.

b. In the *Willoughby* case, the Federal Circuit did not determine that the payments were not "settlements," affirming the Court of Claims' I.R.C. § 104(a)(2) decision only on the ground that the payment were not "on account of personal injuries." *See* 00-1066 Pet. App. 6a.

CONCLUSION

The petitions for writs of certiorari should be granted.

Respectfully submitted,

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